

NO PROTEST
Release 30000

Yellow

Date [REDACTED]

Signature [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Taxpayer:

This refers to your application for recognition of exemption from federal income tax as an organization described in § 501(c)(15) of the Internal Revenue Code.

FACTS

The information furnished shows that you were incorporated under the laws of [REDACTED] and [REDACTED]. You represent that you reinsure vehicle service contracts.

The information furnished shows that your shareholders are [REDACTED] and [REDACTED]. The vehicle service contracts reinsured by you are sold by [REDACTED] and [REDACTED]. The ownership of the above-listed dealerships is as follows:

[REDACTED]

The dealerships act as an agent for the sale of vehicle service contracts to its customers. All insurance policy sales proceeds, less the dealership's commissions are forwarded to [REDACTED] (General) which insures and administers the policies. General then administers the insurance policies and reinsures such policies with you pursuant to a reinsurance contract.

You state that you were unable to obtain a copy of the

[REDACTED]

policies or certificates that were used during the time [REDACTED] was reinsuring extended service contract business. You no longer reinsuring extended warranty contracts. Your financial information shows no net written premiums for [REDACTED] and [REDACTED] for year ended [REDACTED]

LAW AND ANALYSIS

Section 501(c)(15) provides that "[i]nsurance companies or associations other than life" are exempt from taxation under § 501(a) if "net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000." § 501(c)(15)(A).

The principal test for what constitutes "insurance" for federal income tax purposes is set out in Helvering v. Le Gierse, 312 U.S. 531 (1941). In that case, the Supreme Court stated that "[h]istorically and commonly insurance involves risk-shifting and risk-distributing." Id. at 539. Further, the Court stated that this risk must be an "insurance risk" as opposed to an "investment risk." Id. at 542. In Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068, 1074 (1976), aff'd, 572 F.2d 1190 (7th Cir. 1978), the Tax Court wrote that this risk is a risk of "a direct or indirect economic loss arising from a defined contingency," so that an "essential feature of insurance is the assumption of another's risk of economic loss."

Rev. Rul. 77-316, 1977-2 C.B. 53, addressed three situations in which a domestic corporation and its domestic subsidiaries paid amounts, designated as insurance premiums, directly or indirectly to the parent's wholly owned foreign "insurance" subsidiary. In Situation 1, the parent and its subsidiaries paid amounts directly to the insurance subsidiary. In Situation 2, the parent and its subsidiaries paid amounts to M, an unrelated domestic insurance company, under a contractual arrangement providing that M would remain as the primary insurer but immediately "reinsure" 95 percent of the risks received with the parent's insurance subsidiary. In Situation 3, the parent and its subsidiaries paid amounts directly to the insurance subsidiary, but the insurance subsidiary then transferred 90% of the risks to W, an unrelated insurance company, in a reinsurance transaction. The ruling noted that, in all situations, the insurance subsidiary and the parent's other subsidiaries were under the common control of the parent. In no situation did the insurance subsidiary accept risks from parties other than the parent and its domestic subsidiaries.

Rev. Rul. 77-316 concluded that the arrangements in each of these situations under which the insurance subsidiary assumed "a portion of the risks" of the parent and its domestic subsidiaries was "not insurance under the standards set forth in Le Gierse." Id. at 55. It held that the subsidiaries were "not insurance companies ... because their primary and predominant business activity [was] not the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by other insurance companies." Id. at 56.

Following Rev. Rul. 73-316, other revenue rulings placed importance on the captive insurer and the insured as being, or not being, under common control. In Rev. Rul. 78-338, 1978-2 C.B. 107, 31 unrelated shareholders owned a corporation from which they purchased insurance; no shareholder's individual risk could exceed 5% of the total risks insured by the company. The ruling stated that "[n]o shareholder own[ed] a controlling interest in the insurance company," and concluded that, "because the taxpayer and the other insureds-shareholders are not economically related," the arrangement would be treated as insurance for federal income tax purposes. In Rev. Rul. 83-172, 1983-2 C.B. 107, 40 employers formed a insurance exchange for the purpose of insuring their liability under the state workmen's compensation law. No single employer in the group provided more than 5 percent of the total risk insured by the fund. The ruling found that the members of the group were not "economically related or commonly controlled." Id. It held that the fund would be treated as an insurance company other than a life insurance company for federal income tax purposes. Id. at 108.

Your sole business is indemnifying the risks of your owner's automobile dealerships under service contracts on which the dealerships are liable. Both you and the dealerships are under the common control of the same majority shareholder. Your business is substantially similar to that of the company in Situation 2 of Rev. Rul. 77-316. We find that you are not an insurance company or association other than life, and your request for recognition of exemption under § 501(c)(15) is denied.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days of the date of this letter. You also have a right to a conference in this office after your statement is

[REDACTED]

submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need you to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

You will expedite our receipt of your protest statement by using the following address on the envelope:

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the Southeast key District Office, which is located in Baltimore, Maryland. Thereafter, any question about your federal income tax status should be addressed to that office. Thank you for your cooperation.

Sincerely yours,

[REDACTED]

[REDACTED]

[REDACTED]